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Supreme Court of the United States

October Term, 1967

NORFOLK AND WESTERN RAILWAY COMPANY,
Appellant

v.

UNITED STATES OF AMERICA, et al.,
Appellees

On Appeal from the United States District Court
for the Southern District of New York

BRIEF OF APPELLANT IN OPPOSITION TO MOTIONS TO AFFIRM

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Appellees refuse to face reality. They acknowledge, as they must, that the Commission's order in this *Inclusion* case was entered on the express finding that N&W would acquire as subsidiary corporations a package of three profitable railroads. But appellees do not, and cannot, dispute our showing that the three railroads are operating at a deficit today, even before the impact of Penn-Central, and that, in any event, the package will be broken by one or two of the railroads.

Instead of facing the normal consequences of these facts, requiring that the Commission's order be set aside as arbitrary and unlawful, appellees ask this Court to brush aside these problems on grounds of administrative expertise and discretion. But Congress enacted the

Administrative Procedure Act to provide judicial protection against arbitrary and unsupported agency action. The need for performing this statutory duty is especially great in this case in which the public interest in the preservation of three railroads as competitors of Penn-Central is at stake.

1. The Commission Has Not Found That Any Public Interest Would Be Served By Directing N&W To Acquire The Stock Of Deficit Railroads.

EL is now operating at a *deficit* of approximately $10 million a year. In response to our argument that the Commission has not found that acquisition of EL as a deficit railroad would be in the public interest, the Government states: "The argument begs the essential question of whether the three roads would experience future deficits" (U.S. Mo. Aff., p. 18, n. 12a). This response not only begs the question but reflects a misconception of what the Commission actually did in finding EL's "normal" earnings.

EL's Motion to Affirm accurately summarizes the development of the Commission's finding that EL's normal earnings as an independent carrier are $9.5 million. EL's reported earnings rose from a deficit of $8.3 million in 1964,[1] to an average net income of $5.0 million for

[1]In 1964, the Commission found that "Erie-Lackawanna's financial condition is such as to render it impossible to frame terms for its inclusion which would be, as required by statute, fair, equitable, or reasonable to the Norfolk & Western and its stockholders" (324 I.C.C. at 22).

1965-1966 (EL Mo. Aff., p. 5).[2] As EL states (*id.* at 5, n. †):

> "The major adjustment made by the Commission in estimating EL's future contribution to the N&W system was to add to EL's average reported results during 1965-66 $4.5 million ($6.8 million less $2.3 million) representing additional commuter relief obtained from the State of New Jersey not reflected in 1965-66 results. 330 I.C.C. at 813-14."[3]

Thus, the Commission's process was not to make a long-range forecast that someday EL would achieve earnings of $9.5 million. To the contrary, the finding was that, with the commuter subsidy, that level of earnings had been achieved and constituted EL's "normal" level of earnings. And that finding was based, as EL states, on the premise that EL earnings had achieved a sensational "turnaround" since 1964 (EL Mo. Aff., p. 4).

Some turnaround. EL earnings have made a complete circle. Starting from a deficit of $8.3 million in 1964, EL earnings rose to an average of $5.0 million in 1965-1966 and have now turned back to a deficit in 1967 even greater than that experienced in 1964.

The Commission's finding of $9.5 million EL "normal" earnings cannot be passed off as permissible administrative forecasting when, at the time the case was

[2]To conform to EL's method, these earnings figures are stated as reported and before deduction of full contingent interest charges. In terms of earnings available for stockholders after full contingent interest charges, the reported figures must be reduced by $3.3 million (330 I.C.C. at 812, 816).

[3]The full amount of New Jersey commuter subsidy had been realized by EL by the end of 1966 and is therefore fully reflected in 1967 results.

before the Commission, EL had already reported that it had reverted to a deficit operation. It is arbitrary within the meaning of Section 10(e) of the Administrative Procedure Act to pretend that EL has achieved a "normal" net income exceeding $9 million when EL is in fact reporting a deficit of $10 million. And it is doubly arbitrary for the Commission to look at 1967 earnings reports to bolster its approval of the Penn-Central merger (330 I.C.C. at 361)[4] but refuse to acknowledge EL's deficit in the same period.[5]

Nor can this be brushed aside on the Government's theory that this being a matter of "valuation," no court should intrude, since such matters are the special prerogative of agency expertise (U.S. Mo. Aff., pp. 17-18). There is nothing complex or inscrutable about the principal issue before this Court. The Commission found that EL is a carrier with "normal" earnings exceeding $9 million in prescribing the price to be paid by N&W, and this finding is completely arbitrary when that carrier is again experiencing normal deficits.

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[4]Penn and Central continue to rely upon the 1967 decline in their earnings in this Court, citing their reports for the first nine months of 1967 (P-C Mo. Aff. in No. 835, p. 14).

[5]B&M confuses the issue by asserting that it was in light of "traffic gains, control savings and other specific adjustments" that the Commission found that "none of the petitioners will be deficit railroads" (B&M Mo. Aff., p. 8).

In the case of EL, the only significant savings, gains and upward adjustments not already realized by the end of 1966 amounted to $3.4 million (330 I.C.C. at 813) as compared with EL's reported deficit of $7.7 million for the first nine months of 1967.

In the case of B&M, the only savings, gains or adjustments not already realized by 1966 amounted to $1 million (330 I.C.C. at 821, 857) as compared with B&M's reported deficit of $1.5 million for 1966 and $2.9 million for the first nine months of 1967. And the Commission found on reconsideration that it "may have overstated the traffic gains allocable to B&M" (331 I.C.C. at 40).

The Administrative Procedure Act does not exempt such arbitrary agency action simply because value is at issue.[6]

In the district court (J.S. B51), and again in this Court (U.S. Mo. Aff., p. 29; EL Mo. Aff., pp. 10-12), great reliance is placed upon the alleged value to N&W of having a corporate subsidiary reporting tax losses. But quite apart from questions of fairness to N&W, what is the public interest in having deficit carriers as corporate subsidiaries of N&W? How can N&W's use of EL losses as tax deductions from its own income tax help EL to provide transportation service when confronted with Penn-Central competition? Under the tax benefit theory, the greater EL's losses and the more these losses are aggravated by the impact of Penn-Central, the greater the tax benefits to N&W.[7] But the greater EL's losses, the sooner the day will come that the shipping public will be deprived of its essential transportation services.

The whole point of this Inclusion proceeding was supposed to be the public interest in preserving the services of EL, D&H and B&M as railroads able to compete with Penn-Central. These railroads are being forced upon N&W in the name of the public interest, not to reward EL's present stockholders. But the district court,

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[6]The cases cited by the Government (U.S. Mo. Aff., pp. 17-18), all decided prior to the enactment of the Administrative Procedure Act in 1946, do not remotely justify judicial affirmance of the arbitrary and unsupported action of the Commission in this case.

[7]D&H conjectures that N&W may have an interest in keeping EL out of bankruptcy as a continuing tax loss (D&H Mo. Aff., pp. 7-8). But the Commission has never found that continuing EL as a tax loss device meets the public need for a viable competitor of Penn-Central. The Commission has erroneously refused even to face the realities of the problem of EL as a deficit carrier.

and now appellees, simply refuse to face up to the Commission's basic public interest finding that inclusion of these roads "in N&W by way of control" would enable the roads "to continue providing adequate transportation service" because, and only because, "the *normal earnings* of each petitioner after inclusion will be sufficient to meet their fixed charges" (330 I.C.C. at 795). (Emphasis added.)

This is not a game for EL stockholders to win because EL was lucky enough to present its evidence at a time of a temporary upswing in its earnings. The public interest in the future service of these railroads depends upon the integrity of the Commission's finding that EL has substantial "normal" earnings. And it was perfectly apparent to anyone willing to look that, by early 1967, EL had reverted to normal deficits. This Court recognized last Term that, "if not handled properly," the Commission's action could operate "to the great detriment not only of the parties here but to the public convenience and necessity of the entire Nation" (386 U.S. at 392). This is just what is threatened by the arbitrary failure of the Commission to recognize that EL individually, and the three protected carriers collectively, are deficit carriers, and by the refusal of the district court even to acknowledge the existence of this issue.

2. There Are No Findings To Support Inclusion Of EL Alone, Or EL And D&H Without B&M.

Appellees do not, and cannot, point to any finding of the Commission which would justify the inclusion in the N&W system of less than the package of three inter-

dependent railroads. The Government contends that the Commission "implicitly found" that inclusion of only EL, or EL and D&H, would be in the public interest (U.S. Mo. Aff., p. 28). The Government argues that, because the Commission's *order* would require N&W to include EL alone, or EL and D&H, the Commission must have "contemplated"—and implicitly found—that this was in the public interest and equitable to N&W (*id.* at 27). But it is no answer to a claim that an administrative order is unsupported to show what the order requires. The order requiring N&W to include one or two railroads is unsupported because all of the Commission findings are expressly premised on "conditions of four-way control" of all three railroads found to be economically "interdependent" (330 I.C.C. at 793, 834).

The Government also attempts to offset the plain fact that the order will not achieve inclusion of the three railroads in the N&W system by speculating as to what "B&M's own self interest requires" "if B&M remains independent" (U.S. Mo. Aff., p. 28, n. 21; see also EL Mo. Aff., p. 15). But the alternative of B&M independence will be foreclosed by Penn-Central, as the Commission has found (327 I.C.C. at 529, 532). And no appellee now expects B&M to be included in N&W under the *Inclusion* order. Thus the effect of affirming the judgment below would be to make B&M a party to a revenue pool with Penn-Central under the Appendix G indemnity conditions while B&M seeks affiliation with Penn-Central. Under the Commission findings, the Government cannot logically or realistically avoid the consequences of the Commission's action by speculating about what might occur "if B&M remains independent."

Nor can the Government properly avoid the proble presented by D&H's ambivalent stance. Any noti that D&H and B&M can be differentiated is dispelled the following statement of D&H to this Court (D& Mo. Aff., p. 17, n.***):

> "D&H agrees that when B&M is in fact i cluded in any of the major systems under discussio the D&H and B&M properties should be in t same system."

The suggestion of D&H counsel that N&W be requir to buy D&H now in the hopes of selling D&H to Pen Central at such time as B&M is included in that syste (D&H Mo. Aff., p. 17) shows the extremes to whi counsel are driven in attempting to cope with the pro lems inherent in the Commission's failure to determi the ultimate fate of these railroads now, as directed this Court.

Appellees urge that the judgment below be affirme but they avoid like the plague the basis for decisi adopted by the court below. The district court he that the Commission had *not* made findings necessa to support inclusion of EL alone, but stated it wou "not reverse on that ground" solely because of its ov finding that "rejection by D&H's stockholders is unlikely" (J.S. B61). The Government asserts elsewhe that Penn-Central should not be delayed because "pa ticular interests have indulged in a rash gamble" (U Mo. Aff., p. 25). But the shoe is on the other foot. T district court is requiring N&W and the public to gamb on the accuracy of that court's guess that two-thirds D&H's stockholders will affirmatively vote in favor

the Commission's order when the principal stockholde of that railroad, who is also its President, will not sa how he will vote. If the district court has guessed wrong the public interest and N&W both suffer from the en forcement of a Commission order admittedly lacking i essential support.

The Government seeks to excuse the Commission' failure to take account of the conceded possibility tha D&H and B&M stockholders will reject the Commission' order by asserting that "The Commission cannot provid a solution to every permutation and combination o events that ensue from its orders. It can only defin equitable terms that offer an opportunity to be include in a more rationally structured railroad system." (U.S Mo. Aff., pp. 29-30.) This misstates the issue. There ar not that many alternatives to be considered, and th Commission could neither define equitable terms, no protect the public interest, without assessing the al ternatives.

The Commission brought these problems upon itself It could have avoided these alternatives by deciding *th* ultimate fate of each railroad and, having foreclosed othe alternatives, the economic realities of Penn-Centra would have required each carrier to join the railroa system to which it was assigned on the terms prescribe by the Commission. Although this was the course con templated by the opinion of this Court last Term, th Commission chose to proceed step by step, leavin alternatives open and providing an indemnity to enabl the stockholders of the protected carriers to shop aroun after consummation of the Penn-Central merger. Eve

on this step-by-step approach, the Commission was not as powerless as the Government pretends. The Commission could have removed this speculation by requiring the vote of D&H and B&M stockholders, and still can in a matter of weeks.[8]

3. The District Court's Disposition Of The Issues Violates The Standards Governing Judicial Review Of Administrative Orders.

> "*Chenery* requires that an agency's discretionary order be upheld, if at all, on the same basis articulated in the order by the agency itself." *Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156, 168-169 (1962).

In order to uphold the Commission's order, the district court undertook, in violation of the *Chenery* rule, to make findings which the Commission did not make, some of which conflict with findings the Commission did make. In this Court, appellees are again obliged to resort to contentions which were not adopted by the Commission and which are designed to impeach findings the Commission did make.

For example, the Commission found (330 I.C.C. at 840):

> "If B&M were not controlled by N&W but remained an independent carrier the net reduction

[8]EL's vote was taken on August 28, 1967, EL obviously desiring to sell to N&W at the price fixed without regard to the uniquely precipitous decline in EL's earnings. D&H, on the other hand, naturally prefers to defer a vote until the *Inclusion* order is affirmed so that it can then decide whether to accept inclusion in N&W or use the prescribed terms as a floor for further negotiations with Penn-Central.

> in EL and D&H annual gross freight revenues would no doubt be greater. The record does not permit any reliable estimate of the increased loss."

Apart from the fact that the Commission had already found that B&M cannot remain an independent carrier after consummation of Penn-Central (327 I.C.C. at 529, 532), the Commission has (1) failed to find what the loss would be for an EL-D&H system, and (2) has found that the "record does not permit any reliable estimate of the increased loss." Yet the Government presents calculations and assertions asking this Court to find that the "fact is, however, that the differences are very slight" (U.S. Mo. Aff., pp. 28-29; see also EL Mo. Aff., pp. 13-15; D&H Mo. Aff., p. 13).[9] But this is the very fact that the Commission held could not be found.[10]

Moreover, in asserting that the absence of D&H and B&M will have little effect on EL (EL Mo. Aff., pp. 13-15), EL is asking this Court to impeach the Commission's conclusions as to the economic "interdepend-

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[9]The Government errs in asserting that this subject affects only "the price of the roads to be included" (U.S. Mo. Aff., p. 28). The amount of the increase in the loss affects the earnings of each road and that in turn affects both price and ability to compete in the face of Penn-Central (as discussed at p. 6, *supra*).

[10]The Government also suggests that N&W was at fault for not furnishing evidence on this subject (U.S. Mo. Aff., p. 29). But N&W agreed with the evidence, adopted by the Commission, showing the "interdependence" of the three railroads and showing that, if included at all, they should be included as a package. Accordingly, there was no occasion for N&W to present evidence contradicting that showing.

Moreover, the Government is incorrect in saying that N&W presented no independent studies of the effect of Penn-Central on these three roads (U.S. Mo. Aff., p. 29). The Commission found that it was N&W (not the three petitioning railroads) that "produced a clear and comprehensive traffic diversion study" (330 I.C.C. at 837). That study, like petitioners' study of traffic gains relied upon by the Commission, was based on the premise of "conditions of four-way control" (330 I.C.C. at 806, 836).

ence" of EL, D&H and B&M (330 I.C.C. at 793, 832). The short answer to all of these contentions in this Court is that the Commission did not so find, and that its order is not supported by the findings which it did make.

Accordingly, the *Chenery* rule requires that the Commission's order be set aside.

Conclusion

For the foregoing reasons, the Commission's order in this *Inclusion* case should be set aside.

Respectfully submitted,

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